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SUBJECT: Sweden: Update on Impact of Financial Crisis

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¶11. Summary. On December 4 the Central Bank announced its largest ever steering rate cut (by 175 basis points, down to 2.00 percent). The current recession and lack of confidence in the financial markets have severely impacted businesses and households' ability to finance their activities. The OECD report of early December gave Sweden an overall good rating, but pointed to some vulnerabilities: banks' exposure in the Baltics and the problems in the auto industry since Ford and GM officially put Volvo and SAAB, respectively, on their sales lists. Politicians argue over appropriate measures to come to grips with the deteriorating situation, with the government announcing a three-year, USD 2.8 Billion, stimulus package December 5 (septel will have details). Sweden has experienced financial crisis managers in the Government and in the Central Bank. The confidence they instill is giving the government a boost in the polls. End summary.

Dramatic interest rate cut announced

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¶12. On December 4, the Central Bank announced the largest cut in the history of its steering rate (called the "repo rate", which stems from repurchase agreement, and is the rate commercial banks get when borrowing or placing funds with the Central Bank for seven days). The rate was slashed by 175 basis points down to 2.00 percent. The Central Bank stated that it expects it to remain at this level over the next year. The unprecedented cut was considerably larger than the market had predicted. Consequently, we might see effects on rates on the market, since the whole cut had not been factored in.

Economic outlook

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¶13. The economic tendency indicator, presented by the National Institute of Economic Research on November 26, which measures sentiments in the Swedish economy, continued to fall in November. The indicator fell to its lowest value since measurements began in ¶1996.

¶14. Statistics released by Statistics Sweden, the Central Bank, and the Finance Ministry in recent weeks all point in the same direction: Sweden is now in a recession. Commentators agree that the pace of the slow-down has far exceeded their worst fears. Nearly 20,000 layoffs were announced in November. Current unemployment rate projections indicate that it will be approaching the 10 percent mark in 2010. The current uncertainties surrounding the auto industry (Sweden's major export industry at 15 percent of total exports), which currently employs 140,000 people, trouble Swedish politicians in particular and the public in general.

¶15. OECD's prognosis is slightly more optimistic about Sweden's economy, forecasting a growth of 0.8 percent this year, no growth in 2009, and 2.2 percent in 2010 -- which is better than the outlook for the entire OECD area during the next two years. Other prognosis makers, including the major bank SEB, project that Sweden either will enter a recession in 2009 -- or has already entered one in ¶2008. All prognosis makers seem to agree that the outlook brightens in 2010, with a moderate growth rate projected for that year. Sweden's next general election is in September 2010. If the unemployment rate will indeed be approaching the 10 percent mark then, the ruling Alliance government will have a difficult time getting reelected.

¶16. Judging from how the political debate is shaping up now, the

parliamentary election in September 2010 will revolve around a Swedish version of "It's the economy, stupid!" In the financial crisis to date, the Alliance government has earned high public opinion approval ratings. Sweden's current large budget surplus gives Finance Minister Borg a cushion, and will allow for stimulation measures in Sweden to address the domestic situation. The strong state budget puts Sweden in an enviable situation when compared to other European countries.

#### Financial market developments

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¶ 7. The financial sector stabilization plan, which the Swedish government presented to Parliament in record time in late October, is still regarded with uncertainty. To date, of all the major Swedish banks, only Swedbank has joined the government's guarantee fund. Finance Minister Borg has repeatedly signaled his frustration with the lack of support ("solidarity," in his words) from other Swedish financial giants. At first, rumors had it that the rates were rather unfavorable. However, Swedbank came out in support of the program on November 26, commenting that this program had permitted it to secure a long-term loan of 2 Billion Euros, over three years, with an interest rate of 3.6 percent. Swedbank's Head of Treasury, Mikael Edler, commented that obtaining this kind of credit has not been possible since Lehman Brothers collapsed in September.

¶ 8. The Central Bank released its biannual Financial Stability Report November 26, which stated that Swedish banks continue to be financially strong. Even though credit losses have increased marginally, Swedish banks are still nowhere near the predicament they were in during the domestic financial crisis of the early 1990s, commented Deputy Central Bank Governor Lars Nyberg. The Central Bank has conducted stress tests on the Swedish commercial banks, and has found that they earn money, have a strong capital position, and could easily handle increased credit losses simultaneously in Sweden and Latvia.

¶ 9. Recent statistics from Statistics Sweden show that Swedbank and SEB customers withdrew large amounts of deposit funds, primarily in the time period up until the GOS raised the Deposit insurance amount to \$61,000 October 6. Swedbank lost 8 percent of its household deposits, compared to the level in late August. Since then the trend has halted, but this still demonstrates the lack of confidence in banks with substantial exposure in the Baltics. Both Handelsbanken and Nordea, which don't have similar operations in the Baltics, have instead experienced increased deposits during the same time period.

#### Aid to Iceland; Bad Loans in Latvia

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¶ 10. On November 20, Sweden joined Denmark, Finland, and Norway to provide a joint loan worth \$2.5 billion to Iceland to help the country cope with its acute economic crisis. The loan complements a \$2.1 billion credit for Iceland approved by the International Monetary Fund November 19.

¶ 11. Problems in Latvia, Sweden's other financially-troubled neighbor, could have more immediate implications for Swedish banks, due to high levels of Swedish ownership in the Latvian financial sector. One of Sweden's greatest fears is that Latvia will be forced to devalue its currency, the Lat, which is currently pegged to the Euro. Avoiding devaluation is crucial to those Swedish banks with substantial lending in Latvia, and is also a top priority for the Latvian government. Swedbank's CEO commented that "there are strong forces mobilizing to avoid devaluation in Latvia." Swedish Finance Ministry and Central Bank officials have participated in the Latvia, EU, and IMF meetings in Riga over the past weeks.

#### Troubled auto industry

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¶ 12. Car sales in Sweden dropped by 36 percent this November compared to November 2007. For Volvo, the figure was 40 percent, for SAAB 45. (Corresponding figures for U.S. sales of Volvo and SAAB in November were 46 and 57 percent.) Facing financial challenges in their home markets, U.S. auto giants Ford and GM have announced that both Volvo and SAAB are for sale.

¶ 13. The car companies Volvo and SAAB are seen as Sweden's

industrial crown jewels, even though they have been U.S.- owned for around a decade. The current uncertainties about their ownership, and even continued existence, are major news in Sweden these days. Politicians from across the political spectrum have been demanding state intervention, even nationalization, to save the 'Swedish' auto industry. Minister for Enterprise Maud Olofsson has repeatedly explained how EU legislation prevents the Swedish government from providing direct state support to these car giants. However, the Swedish government continues to be under intense pressure to come up with something, anything, to alleviate the situation. A poll conducted in late November showed that 7 out of 10 Swedes would like to see the state temporarily take ownership of Volvo.

New dawn for the Euro debate in Sweden?

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¶14. The few brave voices in Sweden who have dared in recent months to advocate Swedish adoption of the Euro have seen public opinion in favor of the Euro gradually increase. Many Swedes have commented that having a single currency has been a strong driving and unifying force in the Euro zone's response to the financial crisis. It appears that when the Krona is strong, Swedes want to keep it, but when it becomes weakened, they are anxious to be rid of it. However, only one of the four Alliance parties, the Liberal Party, is openly calling for a new national referendum on adopting the Euro. The first EMU referendum was held in September 2003, where the "No"-side won by 53 percent of the votes. In the final analysis, Swedish public opinion will need to firmly and steadily call for Euro adoption before Swedish politicians will dare to initiate talks about a new EMU referendum.

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